

Internal Revenue Service

District  
Director

Delaware-Maryland District

Department of the Treasury

31 Hopkins Plaza, Baltimore, MD 21

Person to Contact:

Contact Telephone Number:

In Reply Refer to:

Date: AUG 26 1999

CERTIFIED MAIL

Dear Applicant,

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

[redacted] was created on [redacted]. The Trust Agreement was amended and restated on [redacted]. The terms of the agreement state that the trustee; [redacted] (now known as [redacted]) would hold the property transferred to it and make quarterly payments from the net income to [redacted]. Upon her death, the balance of the property would be divided into two shares; the first totaling [redacted] of the remaining estate and the second totaling [redacted]%. The larger share was to be distributed to [redacted]. The remaining share, to be held or disposed of for the primary benefit of [redacted]. If [redacted] is deceased, her portion passes to her son. The Trustee shall pay [redacted] in each taxable year of the Trust during her life. Upon her death, such Trustee shall pay to her son, [redacted], if he survives her, during his life an annuity amount equal to [redacted] percent of the initial fair market value of the assets constituting the Trust. Upon the deaths of both [redacted], all property remaining in this Trust shall be distributed to the [redacted].

[redacted] died on [redacted], and the Trust was funded on [redacted]. [redacted] signed a Disclaimer of Trust Interest on [redacted], waiving her rights to the charitable remainder annuity. Her son [redacted] remained as the sole non-charitable beneficiary of the Trust. On [redacted], [redacted] was dedicated in honor of [redacted] at the [redacted].

The Trust claims to be a Charitable Remainder Annuity Trust as described in Section 664 of the Internal Revenue Code. A Charitable Remainder Annuity Trust is a trust-

(A) from which a sum certain (which is not less than 5% of the initial net fair market value of all property placed in trust) is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) may be paid to or for the use of any person other than an organization described in section 170(c), and



- (C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use.

Internal Revenue Code section 4947(a)(2) defines a split interest trust as a trust that (a) is not exempt under IRC 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a charitable deduction was allowed under certain sections of the Code.

There are three common types of split interest trusts, which include pooled income funds as described in IRC 642(c)(5); charitable remainder trusts described in section 664, and charitable lead trusts.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations, which are organized, and operated exclusively for religious, charitable and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations holds that to qualify under section 501(c)(3), one must establish that they are both "organized and operated" exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(b)(1)(i) of the Income Tax Regulations states that an organization is organized exclusively for one or more exempt purposes if its articles limit the purposes of such organization to one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iii) of the Income Tax Regulations states that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower the organization to carry on, otherwise than as an insubstantial part of its activities, which in themselves are not in furtherance of one or more exempt purposes, even though such organization is, by terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(b)(2) of the Income Tax Regulations states the term "articles of organization" includes the trust instrument, the corporate charter, the articles of association, or any other written instrument by which an organization is created.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations states that an organization will be regarded as operated exclusively for exempt purposes only if it engages primarily in activities to accomplish one or more exempt purposes listed in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Thus, in construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States stated, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than private interest. Thus, to meet the requirement of this subparagraph, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization or persons controlled, directly or indirectly, by such private interests. Moreover, even though an organization may have exempt purposes, it will not be considered as operating exclusively for such purposes, if more than an insubstantial part of its activities serve private interests. An organization's founders, directors or officers may not by reason of their position acquire any of its funds.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for exempt purposes if its net earnings inure in whole or in part to the benefit of private individuals.

In Better Business Bureau of Washington, D.C. Inc. v. United States, 326 U.S. 279, the Supreme Court held that the presence of a single noncharitable purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of truly charitable or educational purposes.

In Carrie A. Maxwell, Pasadena Methodist Foundation v. Commissioner, 2 TCM 905 (1943), the court held that a trust set up for the benefit of an aged clergyman and his wife was not exempt because the trust was ruled to be a private trust and not a charitable trust. The trust was set up for the benefit of individuals, and not a charitable class. The court denied 501(c)(3) status despite the fact that the beneficiary was truly a needy person.

In Revenue Ruling 57-449, 1957-2 C.B. 622, a trust created to pay a certain sum to all the individuals enrolled in a certain school on a particular date was held to be a private trust, not a charitable trust.

Your organization was created to be a Charitable Remainder Annuity Trust within the meaning of Internal Revenue Code section 664. The Trust is also a split interest trust as defined in section 4947(a)(2) of the Code, in that it is a charitable remainder annuity trust described in section 664 of the Code, and all of the unexpired interests are not devoted to one or more of the purposes described in section 170(c)(2)(B) of the Code. Charitable remainder annuity trusts are exempt from Federal income tax under section 664; they are not exempt from Federal income tax under section 501(a) of the Code.

The trust does not meet the operational test under section 501(c)(3) of the Code because its primary activity consists of providing annuity payments to designated persons. As the provision of the annuity is a substantial part of the trust's activities, the trust does not meet the requirements of section 1.501(c)(3)-1(c)(1) of the Regulations. The trust is operated to further the private interests of the non-charitable beneficiary; it does not meet the requirements of section 1.501(c)(3)-1(d)(1)(ii) of the Regulations.

The trust serves the private interests of designated individuals. Therefore, the organization does not qualify for exemption under section 501(c)(3) of the Code because it is not organized and operated exclusively for one or more exempt purposes within the meaning of section 501(c)(3) of the Code.



**You are required to file Federal income tax returns for each year that you have been in existence.**

**A copy of this letter will be sent to the appropriate state officials in accordance with section 6104(c) of the Internal Revenue Code.**

**We have sent a copy of this letter to your representative as indicated in your power of attorney.**

If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or if you request, at any mutually convenient district office. If someone who is not one of your principal officers will represent you, that person will need to file a power of attorney or tax information authorization with us.

If you do not appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service." Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

Sincerely Yours,

*Marie Medeck*

Marie Medeck  
Acting District Director

Enclosure: Publication 892

cc: [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]